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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:CORP:B03
PLR-147508-12

Date:
May 03, 2013

Distributing =

Controlled =

Subsidiary =

State X =

Business A =

Business B =

Date 1 =

$$\underline{a} =$$

Agreement =

Dear _____ :

This letter responds to your October 31, 2012, request for rulings regarding certain federal income tax consequences of a series of proposed transactions (collectively, the "Proposed Transaction"). The material information submitted in that request and in subsequent correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Proposed Transaction: (i) satisfies the business purpose requirement of §1.355-2(b) of the Income Tax Regulations; (ii) is being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see §355(a)(1)(B) and §1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing or controlled corporation (see §355(e) and §1.355-7).

Summary of Facts

Distributing, a State X corporation elected to be an S corporation effective Date 1. Distributing owns all of the stock of a number of Qualified Subchapter S Subsidiaries ("QSubs"), including Subsidiary and Controlled. Distributing has voting and nonvoting common stock outstanding which is closely held. The voting stock of Distributing has one vote per share. The stock of Distributing is held by a shareholders.

Subsidiary conducts Business A and Controlled conducts Business B. The financial information submitted by Distributing on behalf of Subsidiary and Controlled indicates that Business A and Business B each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Proposed Transaction

Distributing wishes to separate Controlled from Distributing to save Controlled a substantial amount of state income taxes without a reduction in federal income taxes. Accordingly, Distributing has proposed the following transaction:

- (i) Controlled will create a second class of nonvoting common stock with identical rights as the Distributing nonvoting common stock. Controlled's stock will be comprised of Controlled Class A shares with one vote per share and nonvoting Controlled Class B shares; the shares will have equal rights as to dividend distributions and liquidations proceeds.
- (ii) Distributing will make a deemed transfer of Controlled assets (including Business B assets) to Controlled in exchange for a deemed transfer of all of the Controlled stock to Distributing and Controlled's (assumption of certain liabilities (the "Contribution").
- (iii) Distributing will distribute all of the two classes of Controlled common stock pro rata to its shareholders (the "Distribution"). In the Distribution, holders of Distributing Class A shares will receive an amount of Controlled Class A shares equal in number to their Distributing Class A shares, and holders of Distributing Class B will receive an amount of Controlled Class B shares equal in number to their Distributing Class B shares.
- (iv) Controlled will elect to be treated as an S corporation pursuant to §1362(a).

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to a taxable year, a small business corporation for which an election under §1362(a) is in effect for such year.

Section 1361(b)(3)(A) provides that (i) a corporation which is a QSub shall not be treated as a separate corporation and (ii) all assets, liabilities, and items of income, deduction and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

Section 1361(b)(3)(C) provides that if any corporation which was a QSub ceases to meet the requirements of §1361(b)(3)(B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.

Section 1361(b)(3)(D) provides that if a corporation's status as a QSub terminates, such corporation (and any successor corporation) shall not be eligible to make (i) an election to be treated as a QSub or (ii) an election to be treated as an S corporation, before its 5th taxable year which begins after the first taxable year for which such termination was effective, unless the Secretary consents to such election.

Section 1.1361-4(a)(2)(i) provides that if an S corporation makes a valid QSub election with respect to a subsidiary, the subsidiary is deemed to have liquidated into the S corporation. The tax treatment of this transaction or of a larger transaction that includes this transaction will be determined under the Code and general principles of tax law, including the step transaction doctrine. Thus, for example, if an S corporation forms a subsidiary and makes a valid QSub election for the subsidiary, the transfer of assets to the subsidiary and the deemed liquidation are disregarded, and the corporation will be deemed to be a QSub from its inception.

Section 1.1361-5(b)(1)(i) provides that if a QSub election terminates, the former QSub is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination from the S corporation parent in exchange for the stock of the new corporation. The tax treatment of this transaction or of a larger transaction that includes this transaction will be determined under the Code and general principles of tax law, including the step transaction doctrine.

Section 1.1361-5(c)(2) provides that a corporation may make an S election or have a QSub election made with respect to it before the expiration of the five-year period described in §1361(b)(3)(D) provided that (i) immediately following the termination, the corporation (or its successor corporation) is otherwise eligible to make an S election or have a QSub election made for it; and (ii) the relevant election is made effective immediately following the termination of the QSub election.

Many of the steps described in the representations and rulings below are deemed to occur by operation of law, as described above.

Representations

- (a) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (b) Neither Business A (as conducted by Distributing) nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.

- (c) Neither Business B (as conducted by Controlled) nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.
- (d) The five years of financial information submitted on behalf of Business A conducted by Distributing are representative of the present operation of Business A and there have been no substantial operational changes in the business since the date of the last financial statements submitted.
- (e) The five years of financial information submitted on behalf of Business B conducted by Controlled are representative of the present operation of Business B and there have been no substantial operational changes in the business since the date of the last financial statements submitted.
- (f) Following the Distribution, Distributing and Controlled each will continue independently with its separate employees the active conduct its respective business after the Proposed Transaction.
- (g) The Distribution is being carried out for the following business purpose: save Controlled a substantial amount of state income taxes without a reduction in federal income taxes. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.
- (h) The transaction is not being used principally as a device for the distribution of earnings and profits of Distributing, Controlled or both.
- (i) The total adjusted bases and the fair market value of the assets transferred from Distributing to Controlled each equals or exceeds (i) the sum of the liabilities assumed (within the meaning of §357(d)) by Controlled, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished, and (iii) the amount of cash and the fair market value of any other property (other than stock and securities permitted to be received under §361(a) without the recognition of gain) received by Distributing in the Contribution. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Contribution.
- (j) The liabilities assumed (within the meaning of §357(d)) were incurred in the ordinary course of business and are associated with the assets being transferred.
- (k) No property deemed transferred from Distributing to Controlled has or will claim investment credit under §46.

- (l) No intercorporate debt will exist between Distributing and Controlled at the time of or subsequent to the Distribution, other than as specified in the Agreement. Any indebtedness, if any, owed by Controlled to Distributing on the completion of the Distribution will not constitute stock or securities.
- (m) Distributing, Controlled and their respective shareholders will each pay their own expenses, if any, in connection with the Proposed Transaction.
- (n) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed (within the meaning of §357(d)) by Controlled.
- (o) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (p) The Distribution is not part of a plan or series of related transactions (within the meaning of §1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of §355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (q) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).
- (r) For purposes of §355(d), immediately after the Distribution, no person (determined after applying §355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in §355(d)(5) and (8)) during the five-year period (determined after applying §355(d)(6)) ending on the date of the Distribution.
- (s) For purposes of §355(d), immediately after the Distribution, no person (determined after applying §355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that either: (i) was acquired by purchase (as defined in §355(d)(5) and (8)) during the five-year period (determined after applying §355(d)(6)) ending on the date of the Distribution; or (ii) is attributable to distributions on Distributing stock that was acquired by

purchase (as defined in §355(d)(5) and (8)) during the five-year period (determined after applying §355(d)(6)) ending on the date of the Distribution.

- (t) Immediately after the transaction (as defined in §355(g)(4)), neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of §355(g)(2)).
- (u) Distributing is an S corporation (within the meaning of §1361(a). Controlled will elect to be an S corporation pursuant to §1362(a) on the first available day the Distribution. There is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

Rulings

Based solely on the information submitted and representations made, we rule as follows:

- (1) The Distribution will cause a termination of Controlled's QSub election because Controlled will cease to be a wholly-owned subsidiary of an S corporation. For federal tax purposes, Controlled will be treated as a new corporation acquiring all of its assets and assuming all of its liabilities from Distributing immediately before the termination of Controlled's QSub election in exchange for the stock of Controlled (§§1361(b)(3)(B) and (C)).
- (2) The Contribution, followed by the Distribution, will qualify as a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" within the meaning of §368(b).
- (3) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under §368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under §1361(b)(1)(B). Controlled may, without requesting the Commissioner's consent, make an S election before the expiration of the five-year period described in §1361(b)(3)(D) and §1.1361-5(c)(1), provided that: (i) immediately following the termination, Controlled is otherwise eligible to make an S election; and (ii) the election is made effective immediately following the termination of the QSub election (§1.1361-5(c)(2)).
- (4) Distributing will not recognize any gain or loss on the Contribution (§§361(a) and 357(a)).
- (5) Controlled will not recognize any gain or loss on the Contribution (§1032(a)).

- (6) Controlled's basis in each asset received from Distributing in the Contribution will equal the basis of that asset in Distributing's hands immediately before the Contribution (§362(b)).
- (7) Controlled's holding period in each asset received from Distributing in the Contribution will include the period during which Distributing held that asset (§1223(2)).
- (8) Distributing will not recognize any gain or loss upon its distribution of Controlled stock to its shareholders in the Distribution (§361(c)).
- (9) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing shareholders on the receipt of Controlled stock in the Distribution (§355(a)(1)).
- (10) The basis of the Distributing stock and the stock of Controlled in the hands of each Distributing shareholder after the Distribution will equal the basis of the Distributing stock held by the shareholder immediately before the Distribution. This basis will be allocated between the Distributing and Controlled stock in proportion to the fair market values of the Distributing and Controlled stock immediately after the Distribution in accordance with §1.358-2(a)(2) (§358(a)(1), (b) and (c)).
- (11) The holding period of the Controlled stock received by each Distributing shareholder in the Distribution will include the holding period of the Distributing stock on which the Distribution will be made, provided the Distributing stock is held as a capital asset on the date of the Distribution (§1223(1)).
- (12) Earnings and profits will be allocated between Distributing and Controlled in accordance with §312(h) and §1.312-10(a).
- (13) The accumulated adjustments account of Distributing will be allocated between Distributing and Controlled in a manner similar to the manner in which earnings and profits of Distributing will be allocated under §312(h) in accordance with §1.1368-2(d)(3).

Caveats

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the Proposed Transaction under other provisions of the Code and regulations or the tax treatment of any condition existing at the time of, or effect resulting from the Proposed Transaction that is not specifically covered by the above rulings. In particular, except as so provided, no opinion is expressed or implied

regarding (1), the issuance of Controlled stock in step (i), (2) the validity of Controlled's election to be treated as an S corporation in step (iv), above, (3) whether the Distribution satisfies the business purpose requirement of §1.355-2(b), (4) whether the transaction is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see §355(a)(1)(B) and §1.355-2(d)), and; (5) whether the Distribution and the acquisition or acquisitions are part of a plan (or series of related transactions) under §355(e)(2)(A)(ii).

Procedural Statements

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

It is important that a copy of this ruling letter be attached to the federal income tax return of each party involved for the taxable year in which the transaction covered by this letter is consummated. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their returns that provides the date and control number of the letter ruling.

Pursuant to the power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Richard Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel (Corporate)

cc: